Decision **REVISED DRAFT DECISION OF ALJ JONES** (Mailed 11/1/2002)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks.	Rulemaking 93-04-003 (Filed April 7, 1993)
Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.	Investigation 93-04-002 (Filed April 7 1993) (**Permanent Line Sharing Phase)**

INTERIM OPINION ESTABLISHING PERMANENT RATES FOR THE HIGH-FREQUENCY PORTION OF THE LOOP

(See Appendix A for a List of Appearances.)

TABLE OF CONTENTS

INTERIM OPINION ESTABLISHING PERMANENT RATES FOR THE HIGH-FREQUENCY PORTION OF THE LOOP

1. Summary

This decision adopts permanent Unbundled Network Element (UNE) rates for the High-Frequency Portion of the Loop (HFPL)[1] for both Pacific Bell Telephone Company (Pacific) and Verizon California Inc. (Verizon). The rate for Pacific is $2.48 per loop per month, and for Verizon, $3.00. The methodology adopted allows the rate for the HFPL to be modified, based on changes in adopted loop rates.

The Interim Line Sharing (ILS) decision determined that there should be a true-up, from the interim rates adopted in the ILS proceeding, and the final rates adopted in this Permanent Line Sharing (PLS) Phase. Therefore, Pacific is required to refund the difference between the $5.85 monthly recurring rate adopted in the ILS proceeding, and the $2.48 (or deaveraged loop rates) adopted in this decision to the Competitive Local Exchange Carrier (CLEC) which purchased each loop. Since this decision retains the $3.00 rate adopted for Verizon in the Interim phase, no true-up is required for Verizon.

We find that establishing a separate rate for the HFPL allows Pacific and Verizon to over-recover their loop costs, since they are currently recovering the full cost of the loop—including the HFPL portion—through rates for their existing tariffed services. Pacific and Verizon will be required to return the

[1] The High Frequency Portion of the Loop is that portion used to carry high bandwidth services such as Digital Subscriber Line service (DSL). This is in contrast to the low frequency portion of the loop used to carry voice grade services.

balances in their memoranda accounts and future HFPL revenues to ratepayers using Pacific's Rule 33 and Verizon's A-38 surcharge/surcredit mechanisms.

2. Background

On December 9, 1999, the Federal Communications Commission (FCC) released a decision requiring incumbent local exchange carriers (ILECs) to provide CLECs access to the high frequency portion of the local loop.[2] In its order, the FCC finds that the high frequency portion of the loop meets the statutory definition of a network element, and must be unbundled pursuant to §§ 251(d)(2) and 251(c)(3) of the Federal Telecommunications Act of 1996 (TA96 or Act).

The FCC order strongly encourages states to issue interim arbitration awards setting out the necessary rates, terms, and conditions for access to this unbundled network element (UNE), with any unresolved issues subject to a true-up adjustment when the state commission completes its arbitration. The FCC urges states to issue these awards as quickly as possible after a party petitions for arbitration under the Act, so that CLECs may begin providing advanced services on shared loops by June 6, 2000 (i.e., within 180 days of release of its order). (Line Sharing Order, ¶ 160.)

The Commission opened a new phase of the Open Access and Network Architecture Development (OANAD) proceeding to establish terms and conditions for access to the HFPL. The Commission also determined that the line sharing portion of OANAD would proceed in two phases; the interim arbitration

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[2] Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket Nos.98-147 and 96-98, FCC 99-355, Third Report and Order in CC Docket No. 98-147 and fourth Report and Order in CC Docket No. 96-98, Released December 9, 1999, (Line Sharing Order).

phase concluded in September 2000 with Commission Decision (D.) 00-09-074, with further proceedings to be scheduled for the purpose of setting final rates, and addressing other line sharing issues, with all interim rates subject to true-up adjustment.

Ordering Paragraph 2 of D.00-09-074 indicated that the permanent line sharing phase of this proceeding would determine:

a. final prices, including the issue of double recovery of loop costs and disposition of balances in memoranda accounts;

b. the number of tie cables in an efficient line sharing configuration;

c. whether or not to continue the limitation on decommissioning copper local loop plant pending resolution of line sharing or transport over fiber facilities; and

d. other issues only to the extent specifically added by the ALJ (Administrative Law Judge).

At a Prehearing Conference (PHC), held on May 2, 2001, the assigned ALJ set a procedural schedule for the "permanent" line sharing (PLS) proceeding. She bifurcated the proceeding, and put the issue of a permanent price for the HFPL on a separate expedited track. A separate schedule was developed for the other so-called "noncosting issues." Pursuant to the schedule for the HFPL phase, parties submitted opening and rebuttal testimony in June 2001 on the issue of an appropriate price for access to the HFPL. Additionally, parties addressed whether, if the Commission retains a positive price for access to the HFPL, any portion of that price should be refunded to end users.

On July 2, 2001, parties filed briefs on the need for hearings. Parties agreed that the issue of the price for the HFPL was largely a policy issue, and hearings were not required. At the request of all active parties, on August 2, 2001, at a hearing in the noncosting phase, all the prefiled testimony in the HFPL phase was deemed to have been entered into evidence. Since parties concurred that no hearings were necessary, they agreed to waive the right to cross-examine witnesses. Opening briefs were filed on July 28, 2001, and Reply Briefs, on August 20 and August 27, 2001.

3. The D.C. Circuit's USTA[3] Decision Does Not Preclude this Commission from Setting Permanent Rates for the HFPL

3.1 Background

On May 24, 2002, after the Draft Decision (DD) in this proceeding was released for comments, the D.C. Circuit Court vacated and remanded the FCC's Line Sharing Order. In its review of the Line Sharing Order, the Court found that the FCC, in ordering unbundling of the HFPL to enable CLECs to provide DSL services, failed to consider the relevance of competition in broadband services coming from cable and, to a lesser extent, satellite.

The Court cited information from the FCC's series of § 706 reports[4] that there is robust competition in the broadband market, and the market is dominated by cable modem service. As of the end of June 2001, cable companies had 54% of extant high-speed lines, almost double the 28% share of asymmetric DSL. In its pleadings before the Court, the FCC indicates that it focused solely on DSL because that is what "CLECs seek to offer when they request line sharing." The Court concludes that the FCC adopted the Line Sharing Order

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[3] United States Telecom Association v.FCC, Case No. 00-1012, 2002 WL 1040574 (D.C. Cir. May 24, 2002) (USTA).

[4] Section 706 of the Act requires the FCC and state commissions to encourage the deployment of advanced telecommunications capability. The FCC has issued several reports on the status of deployment, the so-called "706 reports."

with indifference to petitioners' contentions about the state of competition in the market. Verizon filed a motion to suspend the comment period on the Draft Decision (DD) on May 24, 2002, the same day that the D.C. Circuit issued its opinion. Verizon stated that in light of that development, all parties to the docket needed an opportunity to carefully assess their respective positions. There was no time to conduct this assessment before comments were due on the DD. Therefore Verizon asked the Commission to suspend the current running of the comment period on the DD and not to put the DD on the Commission's meeting agenda until further notice. Verizon also filed a motion to shorten time to respond to May 28, 2002, the date set for filing comments on the DD. The assigned ALJ set a revised comment schedule on the DD, through an e-mail to parties on May 28, 2002. Opening comments were filed on June 7, 2002 and Reply Comments, on June 14, 2002. The ALJ allowed 30 pages for each filing to ensure that parties could adequately address both the DD and the D.C. Circuit's opinion.

3.2 Parties' Positions

Verizon and Pacific urge the Commission to hold in abeyance any further consideration of HFPL pricing. According to Pacific, when the D.C. Circuit's mandate issues, the FCC's rules classifying the HFPL as a UNE are null and void, and there will be no lawful basis for requiring Pacific to provide the HFPL to CLECs as a UNE, and no legal basis for setting a permanent price for the HFPL at this time.

Pacific asserts that since the FCC is charged in the first instance with implementing the provisions of §§ 251 and 252 of the Act, including the impairment requirement of § 251(d)(2), there is no state or federal law basis for the Commission to unbundle the HFPL or to price it as a UNE, until the FCC issues new unbundling rules in accordance with the dictates of <u>USTA.</u>

Pacific states that the Commission accepted as a given the FCC's classification of the HFPL as a UNE under the analysis performed by the FCC in its Line Sharing Order, and did not conduct any kind of impairment analysis of the HFPL.

Pacific points out that in light of USTA, FCC Chairman Michael Powell has indicated that the FCC will address the new issues raised by USTA in its reexamination of its unbundling rules and framework in the Triennial Review UNE Rulemaking. According to Pacific, when reexamining the issue of what network elements should be subject to unbundling, the FCC will have to adopt a more rigorous and narrow version of the impair test. The FCC will utilize that more rigorous version of the impair test to determine whether the HFPL should be unbundled at all.

Both Pacific and Verizon urge the Commission to preserve the status quo, pending FCC action to develop a revised "impair" test and issue new unbundling rules. In the interim, both ILECs indicate that they will meet their current line sharing obligations until the uncertainty surrounding the D.C. Circuit opinion is resolved.

The Coalition[5] filed in opposition to Verizon's motion to suspend the comment period on the DD establishing permanent rates for the HFPL, and urged the Commission to issue an order setting permanent rates for the HFPL UNE. According to the Coalition, contrary to Verizon's assertion, the FCC's Line Sharing Order is not the sole source of Verizon's obligation to provide line sharing UNEs to CLECs. The Coalition points out that Verizon is under a

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[5] The Coalition includes WorldCom, Inc., AT&T Communications of California, Inc. (AT&T), Covad Communications Company (Covad), the Office of Ratepayer Advocates (ORA) and The Utility Reform Network (TURN).

continuing obligation until June 2003 under the merger conditions imposed by the FCC in the Bell Atlantic/GTE merger to provide line sharing to CLECs, until the date of any final and non-appealable judicial decision that determines that Bell Atlantic/GTE is not required to provide the line sharing UNE at cost-based rates. Moreover, the Coalition asserts that the FCC has stated unequivocally that "[w]hile we continue to evaluate the Court's opinion and consider all the Commission's options, in the meantime, the current state of affairs for access to network elements remains intact."[6]

The Coalition states that Verizon's Motion to Suspend is premature because the D.C. Circuit's Opinion cannot become effective until the D.C. Circuit issues its Mandate, which will not occur until after July 8, 2002. If parties to the Court's Judgment seek rehearing of the D.C. Circuit's Opinion, it would automatically stay the mandate until disposition of the petition or motion."[7]

The Coalition asserts that the Commission has authority under FCC Rule 51.317 and the California Public Utilities (Pub. Util.) Code to require line sharing and to set an HFPL rate in California. This authority is independent of the FCC's Line Sharing Order.

According to the Coalition, reviewing courts have repeatedly upheld this broad interpretation of the independent unbundling and ratemaking authority of state commissions. At the highest level, the U.S. Supreme Court reviewed and implicitly approved independent state authority pursuant to Rule 51.317. In AT&T Corp. v. Iowa Utilities Bd., the Supreme Court noted that "[I]f a

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[6] Statement of Chairman Michael Powell, available at www.fcc.gov/Speeches/Powell, Statements/2002/stmkp212.html.

[7] FED.R. APP. PROC. 41(d)(1).

requesting carrier wants access to additional elements, it may petition the state commission, which can make other elements available on a case-by-case basis."[8]

In addition, the Coalition points to Pub. Util. Code § 709.7 which directs the Commission to "expeditiously examine" line sharing and, if appropriate, adopt unbundling requirements for ILECs, even if the FCC did not issue an order for line-shared loops.

The Coalition asserts that they demonstrated in their opening and reply briefs that CLECs are impaired without access to the line sharing UNE under all ten factors set forth in FCC Rule 51.317(b)(2)-(3). If, however, the Commission decides that it needs additional facts to enter an independent finding that CLECs are impaired without access to the HFPL UNE, the Commission should order a limited reopening of this proceeding for the purpose of admitting evidence on the expanded impair standard enunciated by the D.C. Circuit's Opinion.

The Coalition stresses the need for continuation of line sharing during any limited remand of the line sharing issues. CLECs currently provide DSL-based service on line-shared loops to more than one million customers in California. Disconnection of those circuits would be an economic and regulatory nightmare. The Coalition urges the Commission to use its general regulatory authority to require Pacific and Verizon to continue providing line sharing during the pendancy of the limited remand.

In addition, the Coalition indicates that other states have exercised authority to establish additional UNEs. The Minnesota PUC used its authority to

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[8] AT&T Corp. v. Iowa Utilities Bd., 525 U.S. 366, 388 (1999) (IUB). While the Supreme Court remanded FCC Rule 51.319 (the necessary and impair standard) back to the FCC for further justification, it did not remand or note any disfavor with FCC Rule 51.317.

order unbundling of line sharing before the FCC did.[9] The Coalition also cited instances where the Texas PUC has exercised its authority to order unbundling of additional UNEs. The Texas PUC determined that local switching should be available to CLECs on an unbundled basis without restriction, as should operator service and directory assistance.[10]

3.3 Discussion

According to Pacific and Verizon, as a result of the D.C. Circuit's Opinion, there is no legal justification for requiring the ILECs to provide the HFPL to CLECs as a UNE, and correspondingly no lawful basis for setting a permanent UNE-based price for the HFPL until the FCC issues a new "impair" test and new unbundling rules. According to the ILECs, those new FCC unbundling provisions will determine whether the ILECs can be legally required to unbundle the HFPL in the future. We find Pacific's assertions that the HFPL is no longer classified as a UNE or subject to UNE pricing rules to be premature, in light of the fact that the line sharing order is still in effect.[11]

On September 4, 2002 the Court denied WorldCom, Inc.'s petition for rehearing and also ordered that the vacatur of the Line Sharing Order be stayed

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[9] In the Matter of a Commission Initiated Investigation into the Practices of Incumbent Local Exchange Companies Regarding Shared Line Access; Docket No. P-999/CI-99-678 (Oct. 8, 1999).

[10] Reply Comments of the Texas PUC, at 2 (citing Petition of MCIMetro Access Transmission Services LLC for Arbitration of an Interconnection Agreement with Southwestern Bell Telephone Company Under the Telecommunications Act of 1996, Docket No. 24542 (May 1, 2002).

[11] On December 3, 2002, AT&T, WorldCom and Covad filed a petition asking the U.S. Supreme Court to review the appeals court's decision in USTA.

until January 2, 2003.[12] Therefore, the FCC's Line Sharing Order is not vacated, and continues to apply as a matter of law. As a practical matter, however, SBC has committed to complying with the order until the FCC reconsiders its rules and issues a further order. For its part, Verizon is bound by the line sharing order pursuant to a merger agreement which requires Verizon to comply with all FCC orders until there is a final, non-appealable judicial determination. Accordingly, until the FCC issues a further order which becomes final, for the foreseeable future the incumbent LECs will continue to offer line sharing as a UNE. And since line sharing is a UNE, states have the authority to adjust the rates for that UNE. This is similar to the situation states encountered following the Eighth Circuit's opinion in Iowa Utilities Board v. FCC in which the Court concluded that the FCC lacks jurisdiction to issue its pricing rules, and vacated the FCC's pricing rules, and put the TELRIC methodology that states had followed in question. In the interim period until the U.S. Supreme Court reversed the Eighth Circuit,[13] the states continued to use the TELRIC methodology to price UNEs.

At issue here then is whether the CPUC may set a permanent rate for this UNE. We believe that it can, pursuant to AT&T Corp. v. Iowa Utils Board, 525 U.S. 366 (2000). In that case, the Supreme Court made clear that the Act maintains the states' authority to prescribe specific rates for UNEs so long as the rates comport with the federal pricing methodology. (525 U.S. at 384.)

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[12] The FCC has asked the D.C. Circuit to extend its partial stay of USTA because the FCC does not expect to complete the remand proceeding by January 2, 2003.

[13] Verizon Communications Inc. v. FCC et al., 122 S. Ct. 1646 (2002).

States may also prescribe line sharing as a UNE pursuant to independent state authority. Under 47 C.F.R. § 51.317, the FCC expressly gave the states discretion to require an incumbent LEC in a given market to adopt additional UNEs to further the pro-competitive goals of the Act. Section 251(d)(3) of the Act itself expressly directs the FCC not to preclude the enforcement of any regulation, order, or policy of a state commission that supplements or complements federal rules.[14] Congress further provided in sections 261(b) & (c) that states could impose requirements "necessary to further competition in the provision of telephone exchange service or exchange access" so long as the such requirements are not inconsistent with the Act or the FCC's regulations implementing it. See also MCI Telecommunications Corp. v. U.S. West Communications, 204 F.3d 1262, 1265 (9th Cir.), cert denied, 531 U.S. 1001 (2000) (citing section 261(c) for state authority to impose additional requirements consistent with the Act and that further competition); In re Petition of Verizon New England, 2002 Vt. LEXIS 12 (Vt. Supreme Court, Feb. 22, 2002) (same). In short, both the FCC and Congress envisioned that the states, pursuant to state law, could adopt regulations, orders and policies independent of the Act, so long as such regulations, orders, and policies are not inconsistent with or do not otherwise substantially prevent implementation of the requirements of the Act.

[14] Section 251(d)(3) provides: "In prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that (A) establishes interconnection obligations of local exchange carriers; (B) is consistent with the requirements of this section; and (C) does not substantially prevent the implementation of the requirements of this section and the purposes of this part."

As AT&T stated in its comments on the Revised Draft Decision (RDD), the Act, the FCC's Rules and authoritative Court decisions all recognize that the FCC's unbundling determinations constitute a floor, and that states may build upon those determinations to establish additional such obligations under both federal and state law. In fact, according to AT&T, the FCC's pre-emptive authority over state authority is extremely limited. Section 251(d)(3)—entitled "Preservation of State Access Regulations"—expressly states that "the Commission [FCC] shall not preclude the enforcement of any regulations, order or policy of a State commission that establishes access and interconnection obligations of local exchange carriers," as long as those obligations are "consistent with the requirements of [§ 251] and do not "substantially prevent implementation of § 251] and the purpose of this part" (47U.S.C. § 261(d)(3)). AT&T also notes that this was confirmed in the <u>UNE Remand Order</u>.

AT&T notes that the RDD applies the state's independent authority to find that the HFPL in California meets the FCC's "necessary and impair" standard. However, the "necessary and impair" standard under § 251(d)(2) is not even binding on the states. According to AT&T, the "necessary and impair' standard that limits the FCC's unbundling rules, has no bearing on the states' authority under § 251(d)(3). By its plain terms, § 251(d)(2) does not apply to the states; it applies only to the FCC, and states therefore cannot "violate" it. The states' unbundling decisions are governed by § 251(d)(3), which expressly permits them to adopt additional "access and interconnection obligations" pursuant to state law, and thus without regard to the federal "necessary" and "impair" standards. According to AT&T, § 251(d)(3) expressly holds the states to a different, less stringent standard.

AT&T also states that the U.S. Supreme Court reviewed and implicitly approved independent states authority pursuant to FCC Rule 51.317. In <u>AT&T</u>

Corp. v. Iowa Utilities Bd. (525 U.S. 366, 388 (1999)), the Supreme Court stated: "[i]f a requesting carrier wants access to additional elements it may petition the state commission, which can make other elements available on a case-by-case basis."

The Coalition appended comments filed by this Commission at the FCC in its proceeding to review unbundling obligations of ILECs, and we take official notice of those comments. This Commission is on record at the FCC that it should continue to require the ILEC to provide access to the HFPL to enable line sharing.[15] We based our position, at least in part, on the following information about the broadband service market in California:

> In addition, more California customers are served by Pacific Bell/SBC's DSL service than by competing cable modem services, and SBC's market share is growing. Currently, in California, there are 735,677 ADSL lines and 609,174 cable lines provided by both ILECs and CLECs. The vast majority of the ADSL lines are provided by Pacific Bell/SBC.[16] And significantly, 11 million Californians, or one-third of all Californians, live in cities where DSL service is the only choice for broadband service.[17]

In the CPUC's Comments, we concluded that alternative technologies to an ILEC's broadband service are not ubiquitously available. Broadband cable

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[15] Comments of the People of the State of California and the California Public Utilities Commission, In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338, April 5, 2002 "CPUC Comments."

[16] CPUC Comments citing In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability, Third Report, FCC 02-33 (February 6, 2002).

[17] This data was provided by California ILECs and the California Cable and Telecommunications Association to the CPUC.

service is limited to areas where the cable plant has been upgraded, but due to the high cost of upgrades, service is provided only in suburban residential communities with some spotty coverage in downtown areas.[18]

Based on our analysis of the broadband market in California, and consistent with USTA v. FCC, we can reasonably conclude that in California *wholesale* markets, line sharing is the only viable option for a CLEC who seeks to compete with the incumbent LEC in providing DSL service at retail. This is because, under current FCC regulations, a CLEC has no right of access to the high-speed transmission component of cable modem service, the functional equivalent of DSL service. Accordingly, we conclude that a CLEC cannot compete effectively in the broadband market unless the CLEC has access to line sharing. Therefore, line sharing should continue to be offered as a UNE. The excerpts from our comments filed at the FCC cited above, are included, not in an attempt to meet the FCC's necessary and impair test (which we agree does not apply to the states), but to give the current status of the broadband market in California.

AT&T asserts that Pacific's claim, in its comments on the RDD, that there is no record evidence to meet the "necessary and impair" test is simply irrelevant, since this Commission is not bound by the FCC's "necessary and impair" test. We concur with AT&T's conclusion that this Commission is not bound by the necessary and impair test.

In California, § 709.7 of the Pub. Util. Code is a clear indication of state policy that directs the CPUC to promote line sharing. In 1999 when that section was added to the Pub. Util. Code, the technical feasibility of line sharing was in

[18] CPUC Comments at 12.

question, unlike today when CLECs are providing broadband service to one million Californians in line sharing arrangements with the ILECs. In 1999, the FCC was still evaluating line sharing, and had not yet issued a final order. The Legislature ordered the Commission to participate in the FCC's proceeding, and indicated that if the FCC did not act before January 1, 2000:

> …the Public Utilities Commission shall expeditiously examine the technical, operational, economic, and policy implications of interconnection as described in subdivision (b) and, if the Public Utilities Commission determines it to be appropriate, adopt rules to require incumbent local exchange carriers in this state to permit competitive local exchange carriers to provide high bandwidth data services over telephone lines with voice services provided by incumbent local exchange carriers. (Pub. Util. Code § 709.7(c).)

Unless it is demonstrated that such policy is inconsistent with, or substantially prevents implementation of the requirements of the 1996 Act, the CPUC regulations promoting line sharing shall be enforced. In enacting § 709.7, the Legislature made it clear that CLECs should have access to line shared loops, and this Commission has an obligation to follow the legislative dictate to ensure that that HFPL is available to CLECs.

The ILECs would have us put this proceeding on hold, pending the outcome of the D.C. Circuit decision. We are not willing to do that. Parties and the Commission have invested significant time and effort in developing this record to enable us to adopt permanent prices for the HFPL, and to resolve some outstanding issues from the line sharing arbitration proceeding. Consistent with §§ 261(b) and (c) of the Act, and given the state's independent authority under Pub. Util. Code § 709.7 and that section's mandate, we have the authority to require line sharing and to set permanent rates for the line-sharing UNE. We exert that authority here and order that ILECs will continue to offer the line sharing UNE, and we adopt permanent prices for the HFPL in California.

4. There Should be a Monthly Recurring Price for Use of the High Frequency Portion of the Loop

4.1. Parties' Positions

4.1.1. Rhythms' Links, Inc.'s (Rhythms) Position

Rhythms asserts that there should be no charge for the HFPL. According to Rhythms virtually all states except California have established a $0 price for the HFPL, having determined that a $0 price complies with pertinent FCC pricing rules and reflects sound economic and regulatory policy. A $0 price is both cost-based and nondiscriminatory. Furthermore, it reflects the pricing decision that Pacific and Verizon voluntarily made for their own Asymmetric Digital Subscriber Line (ADSL) services.

Pacific and Verizon incur no economic cost when the ILEC, or its affiliate, uses the HFPL to provide line-shared DSL services. In contrast, a positive price for the HFPL requires other competitors to incur a real and direct cost.

In the Line Sharing Order, the FCC set forth a simple prescription for establishing a price for line sharing:

> We conclude that, in arbitrations and in setting interim prices, states may require that incumbent LECs charge no more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services. This is a straightforward and practical approach for establishing rates consistent with the general pro-competitive purpose underlying the TELRIC principles. We find that establishing the TELRIC of the shared line in this manner does not violate the prohibition of section 51.505(d)(1) of our rules against considering embedded cost in the calculation of the

> forward looking economic cost of an unbundled network element.[19]

Rhythms points out that Pacific and Verizon in their federal ADSL cost studies did not assign any loop costs to their retail ADSL service. In its Federal filing Pacific stated that no additional loop cost was incurred by the provision of ADSL on an existing voice line, arguing that:

> Several petitioners contend that Pacific must assign outside plant (local loop) costs to its ADSL service. But Commission rules impose no such requirement. FCC Rule 61.38 requires LECs to identify the direct cost to provide the proposed new service. Pacific proposes to transmit ADSL over loops already in service. Pacific already recovers the costs of those local loops under tariffs already approved by the Commission and state regulators. Loop costs therefore contribute nothing to the direct cost of ADSL service.[20]

Verizon has made similar attestations. Verizon's predecessor GTE has stated:

> [s]ince ADSL employs the existing loop for new applications, the costs of the loop are already recovered through existing rates.... [21]

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[19]Line Sharing Order, ¶ 139 (footnotes omitted).

[20] Rhythms citing Reply of Pacific Bell, In the Matter of Pacific Bell, Pacific Tariff FCC No. 128, Transmittal No. 1986, Pacific's ADSL Service, (June 26, 1998) at 15 (footnotes omitted). Rhythms omitted some of the key language from Pacific's filing. The quote included in this order reflects the language of Pacific's actual filing.

[21] Rhythms citing GTE's Reply, In the Matter of GTE Telephone Operating Companies Tariff FCC No. 1, Transmittal No. 1148, May 28, 1998, at 18 (footnote omitted).

Rhythms asserts that Pacific and Verizon advocated a zero cost for use of the HFPL when there were no competitive issues involved. However, now that the ILECs are obligated to provide the HFPL unbundled network element (UNE) to other carriers, they have changed their position.

4.1.2 TURN's Position

TURN lists three reasons why there should be a monthly recurring charge for the HFPL: 1) consistency with the outcome in the Interim Line Sharing Phase, 2) requirements of TA96 § 254(k); and 3) economically correct outcome.

According to TURN, the Commission has already spoken on the threshold question of whether there should be a monthly recurring charge for the HFPL. In its Interim Opinion, affirming the results of the May 20, 2000 Final Arbitrator's Report (FAR), the Commission rejected the proposed zero monthly rate for the HFPL and stated that "…a zero monthly rate is not in the public interest, convenience, and necessity, and we reject a zero monthly rate in the interim." (Interim Opinion, D.00-09-074, September 21, 2000 at 11.) TURN recommends that the Commission reaffirm the outcome reached in its Interim Opinion.

TURN asserts that a monthly recurring charge for the HFPL UNE is necessary to satisfy the requirements of Section 254(k) of TA 96. Section 254(k) reads as follows:

> SUBSIDY OF COMPETITIVE SERVICES PROHIBITED.— A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of

> universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

In a line sharing context, the loop is clearly a shared facility of both voice grade local exchange service and DSL service. And in a line-sharing context, the cost of a copper loop is a shared cost of both voice grade local exchange service (utilizing the low frequency portion of the loop), and Digital Subscriber Line (DSL) service (utilizing the high frequency portion of the loop). TURN states that the FAR in the Interim Line Sharing Phase, which was adopted by the Commission, cited the provisions of 254(k) as one justification for establishing a monthly recurring charge for the HFPL.

According to TURN, the second sentence in § 254(k) must be of concern in this proceeding. The loop is a shared cost of the HFPL UNE and local exchange service, which is the service comprising universal service. It is neither reasonable or lawful for local exchange service to bear the shared cost of the loop, while the HFPL UNE bears no portion of the shared cost. To avoid having universal service bear more than "a reasonable share of the joint and common costs of facilities used to provide both of these services," some portion of the shared costs must be allocated to the HFPL UNE.

TURN's third reason for adopting a monthly recurring charge for the HFPL UNE is that it is economically sound to do so. TURN, ORA, Pacific and Verizon all agree that the HFPL has value and a price should be set for its sale to other carriers. TURN's witness Roycroft presented the following economic rationale for a monthly recurring charge:

- <u>A zero price for the HFPL UNE is not cost-based and would be unreasonable:</u>

  When a local loop is deployed, it is necessary for the provision of a wide variety of services. The costs of the loop are not avoidable when any individual service is discontinued. Arguments that the incremental cost of the HFPL UNE is zero ignore the shared nature of loop input. By definition, a zero price is a non-cost based price.

- A zero price, in effect, assigns all of the benefits of the economies of scope derived from the shared use of the loop facility to the HFPL UNE and none to the other services that are provisioned via the loop:

  If the price for the HFPL is zero, the firms utilizing this resource would be awarded all of the benefits of the expanded scope economies, and the consumers of other services that share the local loop would enjoy none of the benefits.

- A zero price for the HFPL UNE is not sustainable in a competitive market:

  Economies of scope drive down the average total costs of a firm. A zero price for a product or service provided by a multi-product firm that enjoys economies of scope—such as the HFPL UNE—would not be sustainable in the competitive market, nor is it likely that a firm in a competitive market would attempt to price one product at zero and deny the benefits of its scope economies to the customers of its other jointly produced services.

- A nonzero price is consistent with encouraging deployment of, and competition in, advanced services.

TURN also urges that the Commission's determination on the threshold issue of whether a monthly recurring charge should be assessed for the HFPL UNE should also apply to line sharing over fiber-fed loops in a next-generation digital loop carrier (NGDLC) network architecture, such as Pacific's Project Pronto.

4.1.3 ORA's Position

ORA concurs with the finding in the FAR in the Interim Line Sharing Phase that there cannot be an "allocation of zero common cost, zero cost of capital, and zero economic depreciation for the HFPL." (FAR at 65.) As ORA's witness Dr. Johnston stated in his testimony, it would be unreasonable for services that use the loop to escape contribution to collect the cost of the loop. New services over the loops should contribute their share of recovery to loop costs.

ORA asserts that the charge for use of the HFPL must be cost-based. As Johnston explained in his testimony, if the HFPL is not cost-based, it poses significant risks to ratepayers as new digital services replace analog. Thus, if the logic of the interim pricing is continued—that is, adding charges to the unbundled loop for new services such as HFPL instead of allocating use of the HFPL as a portion of the unbundled loop charge—the residual voice services-driven costs of the loop would remain unchanged and the new costs, ascribed to high-bandwidth services riding the copper, would be added to voice charges. Moreover, even as loop costs were going down for the ILEC, since digital services are more cost-effective than analog, the loop price would be going up.

4.1.4 Pacific's Position

Pacific's witness Dr. Fitzsimmons states, "The overriding principle for determining the portion of the shared loop cost to allocate for recovery by the price of the HFPL is that this allocation should allow for a competitive outcome to the greatest possible extent." (Fitzsimmons for Pacific, Opening Testimony at 16.) In a competitive market, a company would not give away a product, such as the HFPL, without expecting something in return. This principle is especially true when to do so would preclude the use of that asset by its owner, as is the case with the HFPL.

Pacific rebuts Rhythms' contention that the price for access to the HFPL should be zero, saying that Rhythms' price proposal would basically require Pacific to subsidize Rhythms' service offerings. According to Pacific, this subsidization is harmful to competition and is financially unfair to Pacific.

Rhythms refers to the following FCC statement to support its demand for a zero price for access to the HFPL:

> States may require that incumbent LECs charge no more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services.[22]

Pacific points out that the FCC's language is permissive, not mandatory; it states what the Commission <u>may</u> do, not what it <u>must</u> do. According to Pacific, Rhythms misses the real point of the FCC's statement. The point the FCC was making is that whatever price is chosen for access to the HFPL, it should not place CLECs at a disadvantage compared to an ILEC's offering of DSL services. According to Pacific the crucial point is that Pacific will not be providing retail DSL service to end-users. Retail DSL service is provided by ASI, a separate affiliate. As applied to this case, the FCC's pricing suggestion means that the price CLECs pay for the HFPL should be the same as the price ASI pays for HFPL.

While Pacific's and TURN's economists agree that the HFPL and the low frequency portion of the loop are joint products, Rhythms characterizes the HFPL as an "enhancement" to the loop. Pacific's witness Dr. Fitzsimmons rebuts that characterization, saying "[f]or over 100 years, economists have recognized

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[22] <u>Line Sharing Order</u> ¶ 139.

that multiple outputs created by the same process are joint products, and the costs of producing the outputs are joint costs." (Fitzsimmons for Pacific, Rebuttal Testimony at 6.) The high and low frequency ranges on a loop are produced in the same process of constructing that loop.

Pacific rebuts Rhythms argument that a positive price for the HFPL is a violation of the principles the Commission established in the New Regulatory Framework (NRF) proceeding. Rhythms attempts to argue that the HFPL is not an innovative new product that Pacific developed, but instead is a new profit center for Pacific. According to Pacific, Rhythms is mistaken. The HFPL is precisely the type of product to which NRF was intended to apply.

4.1.5 Verizon's Position

Verizon supports the Commission's determination in the interim phase of this proceeding that a zero price for the HFPL was not appropriate. The arbitrator considered and rejected the detailed testimony regarding why the price for the HFPL should be zero. The arguments for why the price should be zero that were rejected in the interim phase are essentially the same arguments presented in this permanent phase.

Verizon rebuts Rhythms' contention that a positive price provides an implicit subsidy toward other services. The basis of this argument is that such a price recovers no cost attributable to the HFPL. However, as Verizon contends, the price for the HFPL does recover real costs not directly related to other services. Moreover, the logical result of Rhythms' argument is that allowing CLECs to provide DSL service without contributing to common cost recovery would implicitly subsidize those DSL services.

Also, contrary to Rhythms' claims, Verizon asserts that a positive price does not unfairly discriminate against customers who subscribe to line-shared DSL services. All DSL providers would pay this price, including

Verizon's separate data affiliate, Verizon Advanced Data Inc. (VADI). Rhythms is wrong when it argues that requiring VADI to pay its fair share of Verizon's common costs simply constitutes a shift of revenue from one pocket of the same corporate pants to another. Rhythms' analysis fails to recognize that all DSL providers face intense competition for high speed internet access customers from other sources, such as cable modem providers. Verizon is very aware that every charge imposed on VADI will increase VADI's costs to provide DSL services, affecting its ability to compete.

4.1.6 Discussion

As a starting point, we need to examine the language in the FCC's Line Sharing Order. Both Rhythms and Pacific have cited paragraph 139 from the order to support their position. A careful reading of that paragraph shows that Pacific's interpretation is correct. The FCC's language is permissive when it indicates that states "*may*" require that ILECs charge no more than the amount of loop costs allocated to ADSL services when the ILECs established their interstate retail rates for the service.

In addition, in paragraph 139, the FCC limits its statement to apply to "arbitrations and in setting interim prices." The FCC is silent on the setting of permanent HFPL prices, which is what we are doing in this proceeding. We conclude that the FCC's Line Sharing Order does not require the states, in setting permanent HFPL rates, to rely on the loop costs allocated to ADSL services in ILECs' interstate filings with the FCC. We find that we have the authority, under the FCC's rules, to set our HFPL rates at either a zero-rate or at a rate other than zero.

In their comments on the DD, the Coalition asserts that the FCC's holding that HFPL UNE rates should equal the ILEC's cost allocation for its ADSL retail rate is not merely permissive, as the DD indicates. According to the

Coalition, the FCC later "clarified" its intent in the Access Charge Order.[23] We do not agree. In the Access Charge Order, the FCC is addressing an entirely different issue, and merely makes a brief, although seemingly inaccurate, reference back to its Line Sharing Order. We will rely on the clear language of the Line Sharing Order itself; paragraph 139 of the order was not subject to the D.C. Circuit's review in USTA.

Next we examine the issue of the need to be consistent with the outcomes in our ILS decision. In Ordering Paragraph 2(a) in that decision, we made it clear that the line sharing proceeding would remain open to determine "final prices, including the issues of double recovery of loop costs and disposition of balances in memoranda accounts." In other words, we anticipated that final prices could differ from those adopted on an interim basis, and we are not constrained by the outcomes we adopted in the interim phase of this proceeding. We have developed a more robust record in this proceeding than is generally possible in the expedited arbitration process, which will allow us to set permanent rates. While we may endorse some or all of our earlier rulings in D.00-09-074, we are not required to do so.

TURN has raised the issue of the need to satisfy the requirements of § 254(k) of TA96, and we concur with TURN's concerns relating to the second sentence of that section. Under the requirements of TA96, basic exchange service, which is clearly included in the definition of universal service, should bear "no more than a reasonable share of the joint and common costs of facilities used to provide those services." In a line sharing context, the loop is a joint cost

[23] Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, FCC 00-193, ¶ 98 (rel. May 31, 2000) (Access Charge Order).

because it is used to provide both voice and data services. These costs are distinct from the common costs recovered in the 19% mark-up applied to all UNEs by the Commission. Both voice service and the DSL UNE use the same piece of copper and must pay a reasonable share of joint costs of the loop, pursuant to Section 254(k). The HFPL does not fall within the definition of universal service, so if the voice portion of the loop is absorbing all of the joint and common costs of the facilities used to provide the HFPL, we are in violation of § 254(k).

We believe that the economically correct outcome is to have a positive price for access to the HFPL. An ILEC should not have to subsidize a competitor's operation by providing a valuable asset at no charge, and it is clear that the HFPL is indeed a valuable asset for a CLEC, since it enables the CLEC to offer broadband service.

The norm in a competitive market is that a product or service or productive asset that is in limited supply and has a positive demand should have a positive price. While some may question whether the DSL market is competitive at the present time, that is certainly the Commission's goal.

TURN urges that the Commission's determination on the threshold issue of whether a monthly recurring charge should be assessed for the HFPL UNE should also apply to line sharing over fiber-fed loops in a Next Generation Digital Loop Carrier (NGDLC) network architecture. We believe that it should. This determination is in accordance with an ALJ Ruling issued July 17, 2001, which includes the following statement:

> The ALJ also indicated at the PHC [Prehearing Conference] that this first sub-phase would also include testimony regarding the policy question of whether there should be a monthly recurring price for fiber-fed DLC loops. At the same time, the ALJ further indicated that

> the pricing question of how much that price (if any) should be would be reserved to the second sub-phase (non-costing and NGDLC interim pricing phase). (ALJ Ruling at 4.)

This ruling makes it clear that the policy issue of whether there should be a charge associated with the HFPL UNE over fiber-fed loops is within the scope of this proceeding. Without prejudicing any future decisions we may make regarding unbundling of NGDLC loops, we confirm that there should be a positive price for the monthly recurring access to fiber-fed DLC loops. What that price should be will be determined in the upcoming phase of this proceeding.

5. What is the Appropriate Price for Use of the HFPL?

5.1. Parties' Positions

5.1.1 TURN's Position

TURN asserts that to determine the monthly rate, the Commission must first determine the cost of the loop (including the Commission's shared and common cost markup), then determine the amount of the loop cost that is reasonably subject to recovery from the service utilizing the high frequency portion of the loop. According to TURN, this provides the basis for a reasonable price. TURN proposes monthly recurring rates for the HFPL UNE of $2.0025 for Pacific and $2.3175 for Verizon.

According to TURN, the first issue to be addressed is what cost information the Commission should rely on in setting a reasonable monthly recurring charge for the HFPL UNE. Pacific's loop cost studies are based on 1994 data, and the Commission is currently reexamining those costs in its UNE

Reexamination Proceeding.[24] Verizon presents a special problem because there are no approved cost studies for Verizon in California.

TURN's witness Dr. Roycroft used the FCC's Hybrid Cost Proxy Model (HCPM) that the FCC used to determine the cost of telephone loops for the purpose of calculating the amount of federal funding for universal telephone service provided to all ILECs, including Pacific and Verizon. The HCPM model yielded loop costs of $8.01 for Pacific and $9.27 for Verizon. According to TURN, the FCC's cost information provides a publicly available, reasonable, unbiased, and current basis for use in setting prices.

The second step, TURN states, is to determine a reasonable price for the HFPL UNE. Since the loop is a shared facility of DSL and other services--including local exchange service, vertical features, and toll service--the loop costs cannot be attributed to the production of any single service or product. TURN's witness Roycroft developed his recommended prices using an economic allocation tool known as the Shapley Value. The allocation that results is viewed by researchers to be fair and equitable. Also, the method ensures that the allocation components will always add up to the total cost associated with the shared facility. Also, the application of the Shapley Value is a very straightforward process that can easily be utilized in the future if prices need to be adjusted.

According to TURN, in recent years some have asserted that the term "cost allocation" is akin to an economic profanity. The reality is that the loop is a shared cost of DSL service and other services, and it is simply impossible to directly attribute the entire cost of the loop to any of these services.

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[24] A.01-02-024 / A.01-02-035 / A.01-02-034.

An allocation must take place. Some parties to this proceeding might argue that what TURN is proposing is to re-litigate every single case involving every service that uses the loop. The issue on the table is how to develop a price for the HFPL UNE. It is presumptively unreasonable to set a zero monthly recurring price for DSL line sharing's use of the loop. It is also unreasonable to require the HFPL UNE to bear the entire cost of the loop. So, some apportionment must be made. In developing his pricing recommendations, Roycroft took into account the fact that existing services or products also use the loop, and this fact was relied upon to determine what portion of shared loop costs should be borne by the new HFPL UNE product.

The Shapley Value method addresses the problem of recovering the cost of a shared facility by identifying possible groupings of service offerings that share facilities and assigning unbiased probabilities of each grouping utilizing the shared facility in all possible combinations with other services. According to TURN, the existence of these services was relied upon in TURN's effort to determine what portion of the shared loop costs should be borne by the new HFPL UNE product. TURN allocates the loop costs to four families of services: basic exchange service, toll/access, vertical services, and advanced services, and recommends setting rates at 25% of the total loop costs that result from application of the HCPM model, or $2.0025 for Pacific and $2.3175 for Verizon.

Pacific rebuts TURN's proposal saying that TURN's analysis is based on an improper starting point. TURN begins its analysis of loop costs by stating that first the cost of providing the shared input must be determined. TURN disregards the fact that the Commission set a loop price of $11.70 for Pacific in D.99-11-050, and instead develops its own loop cost using the FCC's HCPM model. The HCPM is based on the Hatfield model, which this Commission has rejected for identifying TELRICs of UNEs. Also, the FCC itself only used the HCPM to determine loop costs in high cost areas for determining universal service support and does not support that model for determining the TELRICs of UNEs.

Pacific states that TURN then determines that access to the HFPL should be priced at 25% of loops costs, based on an allocation of costs among four service families: basic exchange service, toll/access services, vertical features, and high-speed data services. The Commission has consistently rejected the position that costs of the voice grade loop are caused by toll and other services that use the loop. In OANAD, the Commission found,

> [I]t would be inappropriate and contrary to the TSLRIC (TELRIC) principles adopted in D.95-12-016 to treat the loop as a shared cost (with usage services). (D.96-08-021, mimeo at 90-91.)

Pacific also cites similar language in Commission order D.94-09-065:

> We concur with the general principle that NTS [non-traffic sensitive] costs (e.g., loop costs) should be assigned to subscribers' basic exchange services. (D.94-09-065 at 44.)

Pacific concludes that since allocation of loop costs among these four service families has been rejected by the Commission, Roycroft's determination that access to the HFPL should be priced at 25% of the unbundled loop cost should also be rejected.

Verizon points out that while TURN recommends rates based on the FCC's HCPM, neither the HCPM model nor TURN's witness Roycroft's work papers used to generate a price were introduced as exhibits into the record of this proceeding. According to Verizon, the Commission has established a separate phase of this proceeding to calculate costs and prices for line sharing. The current phase was limited to the narrow policy question of whether there should be a positive price for the HFPL, not what that price should be. Consequently, Verizon recommends that the Commission should establish the HFPL price in the cost and price phase of this docket, where the parties may file and fully analyze cost studies. Verizon proposes to present the evidentiary support for its HFPL-related costs in the cost study phase of this proceeding and has presented its cost methodology in this phase for illustrative purposes to demonstrate how direct costs associated with the HFPL may be calculated in the cost and price phase. Verizon recommends that the interim $3.00 monthly recurring rate for the HFPL remain in effect until a final rate is adopted.

Moreover, Verizon does not believe the HCPM is a valid tool to use to establish costs in a UNE docket. The HCPM was used by the FCC in a universal service cost docket. The FCC has warned against using this model in a UNE docket:

> Our USF [Universal Service Fund] cost model provides a reasonable basis for comparing cost differences between states. We have previously noted that while the USF cost model should not be relied upon to set rates for UNEs, it accurately reflects the relative cost differences among states.

Verizon's witness Collins also expresses concerns with the manner in which Roycroft extracted loop cost estimates from the HCPM, which resulted in estimates that are biased downward. Roycroft indicated that in an attempt to focus on copper loops, he eliminated the Common-Language Location Identification (CLLI) codes that identified fiber feeder. As a result, the sample of CLLIs selected tends to be composed of very compact, densely-populated wire centers that have significantly lower loop costs than the statewide average. Roycroft's sample excluded the cost of the copper facilities in the core areas of the remaining lower density wire centers. While these wire centers serve some customers via fiber-fed DLC, customers located within a few miles of the wire center are served over 100% copper facilities. Ignoring these customers (served by copper) imparts a significant downward bias on the cost results.

As a comparison, Collins ran Verizon's Integrated Cost Model (ICM) to test for bias by placing the CLLIs with only copper into a single grouping of wire centers. Collins' results illustrate that the average loop cost for the CLLIs sampled by Roycroft was less than one half of the statewide average loop cost.

5.1.2 ORA's Position

ORA asserts that the price for the HFPL should be cost-based and set as an allocation of the unbundled loop charge. ORA recommends rates of $2.46 for Pacific and $3.00 for Verizon.

ORA makes its calculation by referencing Pacific's witness Scholl's Directory Assistance Decision example, and its allowable markup of 42%. ORA states, "Using this [the 42% markup], the joint and common costs assigned to the high frequency usage could justify a price of no more than $2.46, and therefore the price of the HFPL, could be no higher than that amount." (ORA Reply Brief at 8.)

For Verizon, ORA proposes retaining the $3.00 rate adopted in the Interim Line Sharing phase.

5.1.3 Pacific's Position

Pacific proposes that the Commission retain the $5.85 price for access to the HFPL that was adopted in the interim line sharing arbitration and take the opportunity to utilize these funds to help offset the shortfall in the cost of providing basic residential service.

Pacific states that in its <u>Line Sharing Order</u>, the FCC declared that one loop can actually comprise dedicated connections from a single customer to two different service providers—one providing the customer with voice service, and the other with data service. Either connection, on its own, requires the loop, and none of the loop costs on the shared line are attributable to only one of the two connections. Consequently, standard TELRIC methodology, which was designed for estimating direct costs, is not applicable to pricing access to the HFPL.

According to Pacific, the FCC and this Commission have offered some guidance on the appropriate means of allocating loop costs on a shared line. One of the most fundamental principles of costing recognized by this Commission is the concept of "cost causation." As described in the Commission's Consensus Costing Principles, "Principle No. 2: Cost causation is a key concept in incremental costing…The basic principle of cost causation is that only those costs that are caused by a cost object in the long run should be directly attributable to that cost object." (D.95-12-016, Appendix C.) As described above, the single copper loop can provide both a dedicated voice connection and a simultaneous dedicated data connection. Either connection, on its own, requires the loop, and on a shared line, the two dedicated connections jointly cause the cost of the loop. Consequently, pursuant to this Commission's Consensus Costing Principles, allocation of costs to both the high-and low-frequency portions of the loop is appropriate.

According to Pacific, consumers have several options available if they wish to obtain high-speed access to the Internet. They may purchase DSL service, or they may choose broadband wireless, cable or satellite technologies. This Commission needs to bear in mind what impact an artificially low price for access to the HFPL would have on the broadband market in general.

Pacific states that the Commission should also consider the pro-competitive effect that a $5.85 price for access to the HFPL has had—and will continue to have—on the DSL market. If CLECs have to purchase an entire loop from Pacific, they would pay $11.70. Currently with line sharing, CLECs can purchase just the high frequency portion of that loop at an even more substantial discount—50 percent off the current loop price—down to $5.85. According to Pacific, this clearly provides a significant incentive for CLECs to enter the residential market and offer attractive prices.

Pacific's witness Dr. Fitzsimmons asserts that setting the price for access to the HFPL at 50% of the price of the unbundled loop will make a reasonable contribution to joint loop costs. The $5.85 price has been in effect for several months, and during that time CLECs have purchased increasing volumes of line-shared loops. Pacific sees that that price is spurring deployment of advanced services.

While TURN and ORA claim that an appropriate price for the HFPL is based on less than a 50% allocation of costs, Pacific asserts that TURN begins its analysis from the wrong starting point. TURN claims that the Commission-approved loop rate of $11.70 is too high, and recommends that the Commission set the price for the HFPL based on the loop rate TURN derived from the HCPM.

According to Pacific, TURN errs in applying the Shapley value methodology to reach a price for the HFPL that is 25% of the unbundled loop price because the Commission has consistently rejected the foundation upon which TURN bases this argument: that the loop should be treated as a shared cost with usage services.

Additionally, the HFPL is an appropriate source of contribution to the shortfall that currently exists in the provision of basic services. The Commission has in the past relied on Pacific's above-cost services to contribute to Pacific's losses incurred in the provision of basic service. The Commission's New Regulatory Framework (NRF) under which the Commission placed both

Pacific and Verizon several years ago, does not guarantee Pacific price increases for basic service if it loses market share for those above-cost services. Instead, under NRF, Pacific's challenge is to increase its efficiency and introduce profitable new services.

Rhythms rebuts Pacific's and TURN's allegation that the HFPL is a joint product. DSL-based service is not available to a person who does not subscribe to basic exchange service. Because the stand-alone loop element is already available to serve customers not subscribing to basic exchange service from the ILEC, it is implausible to suggest that line sharing could be defined as anything but an enhancement to basic exchange service. According to Rhythms, the two arrangements could only be considered joint products if they were equally available on a stand-alone basis. That is not the case. Line sharing on a particular loop is available only to the specific customer whose analog voice service is provided over that loop.

Rhythms also rebuts Pacific's witness Fitzsimmons' assertion that the approach he advocates is an allocation of loop costs. As ORA witness Johnston has correctly observed, Pacific has not actually proposed to allocate loop costs among multiple uses of the loop. It has proposed additional revenues on top of those that it received prior to the requirement to provide line sharing. According to Rhythms, Pacific's allocation scheme is simply a mechanism to allow Pacific to recover more than the total cost of the loop from those customers who order both basic exchange and line shared DSL services over the same loop.

Rhythms states that because line-shared access to the loop creates no loop cost, Fitzsimmons focuses on the asset value of that access, and in so doing, proposes a charge to replace the profit that Pacific could have generated with that asset, were it not for the requirement to allow competitive access. However, this loss of profit occasioned by allowing competitive access is a private opportunity cost to a monopolist, not a cost to society as a whole. According to Rhythms, the FCC specifically rejected “opportunity cost” pricing for UNEs at paragraphs 708 and 709 of the *Local Competition First Report and Order.*

Rhythms disagrees with Pacific’s conclusion that a positive HFPL rate is needed to subsidize basic service. In the Commission’s Universal Service docket, the Commission has already created an explicit universal service funding mechanism that is designed to deliver all of the subsidy that the Commission deems necessary to support residential basic exchange service. In addition, the Commission also required Pacific to offset that additional revenue by reducing prices for other services.

Moreover, states Rhythms, Pacific has not presented any convincing evidence to establish the need for a subsidy of its retail local exchange prices. Pacific’s witness Scholl relies on the premise that the combination of residential basic exchange prices plus California High Cost Fund - B (CHCF-B) funding should recover the entire cost of basic exchange service plus a 46% allocation of Pacific’s retail shared and common costs. This allocation of shared and common costs far exceeds the amount the Commission found to be a reasonable allocation to basic exchange service in its Universal Service decision, D.96-10-066. In that decision, the Commission concluded that:

> As TURN points out, Congress recognized that potential in the Telco Act, which contemplates that universal service should bear no more than a reasonable share of joint and common costs, and in the Conference Report, which suggests that the cost of universal service bear less than a reasonable share. Consistent with that direction, we have reduced common costs per line from $2.91 to $2.00 to safeguard against these possible competitive problems. We note that the revised common costs are a more reasonable allocation. The reduced amount represents approximately an 11% mark-up over direct

> and shared costs, which is commensurate with the overhead factors experienced in the local exchange industry.

Rhythms also asserts that Pacific's proposal that a charge equal to 50% of the UNE loop price, yields a rate of $5.85, is not entirely correct. The FCC requires deaveraged prices for the UNE loop, and Pacific has agreed to deaveraged loop prices on an interim basis in its ICA with MCImetro Access Transmission services, L.L.C. Hence, if the Commission adopted Pacific's proposed 50% of the loop price, the correct price for access to the HFPL would be 50% of the UNE loop price in each deaveraged zone.

ORA rebuts Pacific's argument that the proposed price of $5.85 will be pro-competitive because CLECs have purchased increasing volumes of line shared lines during the 13 months the interim price has been in effect. ORA points out that the "CLEC" that is purchasing the increased volumes is SBC's ASI, not an unaffiliated CLEC. According to ORA, ASI has purchased more than 95% of those line-shared loops.

5.1.4 Verizon's Position

Verizon asserts that there are direct costs associated with providing the HFPL UNE. Only by investigating this cost as compared to the cost of unbundled POTS (Plain Old Telephone Service) loops can the appropriate cost-based HFPL share be determined. Until this matter is resolved in the costing phase, Verizon recommends that the interim rate of $3.00 per month be continued.

Verizon states that in the interim phase, the company had not identified any incremental loop costs caused by providing the HFPL over home-run copper loops,[25] and consequently did not propose a positive price for the HFPL. Since that time, Verizon has identified "embedded constraint" incremental costs associated with providing the HFPL over copper loops. Providing the HFPL over home-run copper loops will take place on Verizon's existing network, which has many copper loops that are 12-16 kft in length. In a forward-looking environment, those same loops may well be converted to hybrid fiber/copper loops. If Verizon is providing the HFPL on the existing all-copper loop, it cannot efficiently introduce fiber into this loop or convert that customer to a hybrid fiber/copper loop.

ORA disagrees with Verizon's sudden conversion to finding a direct cost associated with providing the HFPL. No TELRIC rationale can be found to justify recovery of "embedded" costs. Further, Verizon's disinclination to migrate DSL customers to fiber is an artificial one, not a legal or technical requirement.

Rhythms asserts that Verizon's "embedded constraint" theory violates the FCC's rules for pricing UNEs. First, Verizon's witness Collins' premise is false because line sharing arrangements need not be limited to all-copper loops. The very schedule for this docket demonstrates that the Commission intends to develop prices for an arrangement to provide access to the HFPL over a forward-looking, fiber-fed network architecture. According to Rhythms, Verizon is actively engaged in upgrading the DLC equipment in its local exchange affiliates' networks to facilitate the provisioning of DSL-based services over fiber-fed loops. Also, Verizon has publicly announced an

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[25] Home-run copper loops are those loops totally composed of copper facilities, from the customer's premise to the Central Office.

agreement with Alcatel to purchase an estimated $800 million of ADSL electronics. Collins fails to suggest what constraint requires Verizon to continue to provide access to the HFPL over all-copper loops.

According to Rhythms, Collins' proposal violates the requirements of the FCC and this Commission that UNE prices be based on forward-looking economic cost. Collins incorrectly suggests that the price for access to the HFPL UNE should be based on the difference between Verizon's estimate of the forward-looking cost of the loop and an entirely different cost standard. In other words, the cost assigned to access to the HFPL would be, by definition, an amount above and beyond the forward-looking cost of the loop or any measure of forward-looking economic cost. This is a clear violation of the current pricing standard for UNEs.

TURN points out that the Washington Utilities and Transportation Commission (WUTC) order[26] Verizon cites in support of adopting a monthly recurring charge for the HFPL includes sections that Verizon did not quote. Specifically, the WUTC also includes its rationale for supporting its determination that the loop is a shared cost of both voice exchanges services and DSL service in a line-sharing environment. According to TURN, the WUTC decision affirms the obvious: in a DSL context, the loop is a shared input to both voice and data services, and it is a shared cost of both services.

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[26] Before the Washington Utilities and Transportation Commission, Docket No.UT-003013, In the Matter of the Continued Costing and Pricing of Unbundled Network Elements, Transport and Termination, Thirteenth Supplemental Order, Part A Order Determining Prices for Line Sharing, Operations Support Systems and Collocation, January 31, 2001.

5.1.5 Discussion

We begin our discussion of the proper price for the HFPL by stating that we are making a policy determination, not analyzing TELRIC cost studies or other scientific data to determine the HFPL price. We point to the assigned ALJ's Ruling of July 19, 2001, which denied Rhythms' motion to strike testimony filed by other parties. Rhythms asserted that TURN's witness Roycroft's testimony exceeded the defined scope of the HFPL pricing phase. According to Rhythms, the discussion at the May 2, 2001 PHC made it clear that such testimony was not to include cost studies reexamining the underlying loop rates, but was to be limited only to a discussion of whether any portion of the already existing UNE loop rate should be allocated to CLECs' use of the HFPL for DSL service.

In ruling on Rhythms' motion to strike, the assigned ALJ concluded as follows:

> Rhythms has taken much too narrow a view of the scope of the HFPL proceeding. While other parties agree that this is a policy issue, they are not precluded from submitting cost data which serves as the basis for their policy positions.

We reiterate that we are making a policy decision on the proper charge for the HFPL, based on the record evidence presented in this proceeding. We do not purport to base our adopted rate on a detailed cost study for the HFPL.

TURN uses the FCC's HCPM model to develop loop rates for both Pacific and Verizon. As Pacific points out, the Commission has already adopted an $11.70 loop rate for Pacific.[27] Also, Verizon claims that the way TURN extracted loop cost estimates from the HCPM was biased. Verizon then recalculates those loop costs, using its own ICM model. As Verizon states, neither the HCPM or TURN's workpapers are included in the record of this proceeding. We note that the same holds true for Verizon's ICM model and workpapers. We are left with two models before us, with different conclusions, and no way for us to validate either model. Therefore, we will not rely on either the HCPM or Verizon's ICM in making our determination of the proper price for the HFPL. In addition, TURN acknowledges that the HCPM was developed by the FCC to develop costs for determining universal service support, not for developing costs for UNEs. Pacific points out that the FCC stated in the Kansas/Oklahoma 271 Order that the HCPM model "should not be relied upon to set rates for UNEs."[28] As Pacific states, contrary to the FCC's explicit direction, TURN now asks the Commission to do just that. We have adopted an interim loop rate of $9.93 for Pacific, and the Commission-adopted rate will form the basis for our determination of the proper price for the HFPL.

Pacific proposes a rate of $5.85 for the HFPL, and suggests that that amount will assist Pacific in making up some of the shortfall associated with

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[27] The 1999 loop rate has been replaced by an interim loop rate of $9.93 for Pacific which the Commission authorized in D.02-05-042.

[28] In the Matter of Joint Application by SBC Communications, Inc., Southwestern Bell Telephone Company, Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, Memorandum Opinion and Order, FCC 01-29 (Rel. Jan. 22, 2001) at ¶ 84.

providing residential basic exchange service.[29] In this case we are pricing the HFPL as a UNE and must follow the FCC's rules for pricing UNEs. CFR Rule 51.505(d) lists the factors that may <u>not</u> be considered in calculation of the forward-looking economic cost of a network element. Subsection (4) reads as follows:

> <u>Revenues to subsidize other services</u>. Revenues to subsidize other services include revenues associated with elements or telecommunications service offerings other than the element for which a rate is being established.

We find that Pacific's proposal to collect $5.85 or 50% of our adopted loop rate violates Rule 51.505(d)(4), which bars states from setting UNE rates which include revenues to subsidize other services, which is precisely what Pacific is proposing. While the Commission in the past has relied on above-cost services to subsidize below-cost services, that sort of cross-subsidization is not appropriate in the pricing of UNEs.

Nor do we agree with Pacific's argument that the CLECs are lucky to pay only $5.85, because if they have to purchase the entire loop, they would pay $11.70. This argument is spurious because CLECs who utilize the HFPL are competing with Pacific's separate affiliate ASI, which supplies service over line-

[29] We disagree with Pacific's basic premise that there is a shortfall associated with providing residential basic exchange service. In 1996 we created an explicit subsidy system in the CHCF-B to subsidize residential loops in high-cost areas, and eliminated the implicit subsidies needed to support residential basic exchange service. The Cost Proxy Model adopted in D.96-10-066 was used to estimate the cost of providing residential basic service and determined the amount of subsidy needed for providing universal service. Pacific, and other ILECs, are entitled to subsidy support for those high-cost Census Block Groups.

shared loops. It is not economically feasible for a competitor to pay $11.70, and then attempt to compete against ASI with its lower loop cost.

Next we examine Verizon's proposal that the current $3.00 HFPL rate which was adopted in the Interim phase be continued until final pricing. Verizon has the mistaken impression that this phase of the PLS proceeding is scheduled to address only the policy issue of whether there should be a positive price for the HFPL, not what that price should be. Verizon is mistaken. This phase of the PLS proceeding is scheduled to set a permanent price for the HFPL, to replace the interim rates adopted in the Interim Line Sharing phase in D.00-09-074. At the PHC on May 2, 2001 in the PLS proceeding, Rhythms counsel indicated that this phase is to determine "on a permanent basis what the monthly loop recurring price should be, if any, for the HFPL."[30] The assigned ALJ cited this section from the transcript in her July 19, 2001 Ruling denying Rhythms' motion to strike certain testimony filed by other parties. This phase of the PLS proceeding will set the permanent HFPL rate; that issue is not scheduled to be addressed further in the costing phase of this proceeding.

Verizon indicates that in the costing phase, it intends to propose a rate of $7.32 based on what it terms its "embedded constraint" theory. Since this represents Verizon's proposal for a permanent HFPL rate, we will examine Verizon's proposal here. As Rhythms and ORA point out, Verizon's proposal to recover the costs of retaining its home-run copper network to provide HFPL to customers since it cannot efficiently introduce fiber into a loop or convert that customer to a hybrid fiber/copper loop, violates the FCC's rules on factors that

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[30] RT at 1491, Prehearing Conference in Permanent Line Sharing Phase of OANAD, May 2, 2001.

may not be considered in pricing unbundled network elements. CFR Rule 51.505(d) (1) reads as follows:

> Embedded costs. Embedded costs are the costs that the incumbent LEC incurred in the past and that are recovered in the incumbent LEC's books of accounts.

Verizon's investment in its copper network clearly fits in this category of embedded costs that cannot be considered in setting a price for UNEs. Verizon's embedded constraint theory violates CFR 51.505(d)(1). We reject Verizon's proposal for setting a permanent HFPL rate of $7.32.

In the 1999 Pricing phase of our Open Access and Network Architecture Development (OANAD) proceeding, we adopted a loop rate of $11.70 for Pacific. However, shortly after the release of the DD in this proceeding, the Commission set new interim UNE loop and switching rates for Pacific in the UNE Reexamination proceeding. In Decision 02-05-042, we approved an interim rate of $9.93, which we will use as the basis for determining the permanent price for the HFPL for Pacific. However, we will set a procedure in place so that if Pacific's loop rate changes as a result of setting permanent UNE rates in the UNE Reexamination proceeding, or any other proceeding, that new loop price will then be used to readjust the HFPL rate as well, without further proceedings before this Commission.

We need to determine how to allocate costs between two UNEs that both utilize the loop-voice service which uses the low-frequency portion of the loop and the HFPL. Parties have made a number of comments about the allocation of costs between the high and low frequency portions of the loop. At the heart of this issue is the question of whether the loop is a shared cost. In the

Commission decisions cited by Rhythms and Pacific,[31] the Commission looked at this issue in a different context. In those proceedings, we were looking at the issue of whether basic exchange service or the loop is a shared cost, such that the costs of providing it should be recovered through the various services that use it. The issue centered on whether some of the costs of the loop should be recovered in the prices of services that use the loop. That issue is not on the table here – no price changes are being proposed for any existing retail service. Instead, the Commission is setting a price for a new UNE—the HFPL. In those earlier decisions we decided that it is not appropriate to treat the loop as a shared cost.

What we are dealing with here is clearly distinguishable from the issues in these earlier decisions. For one thing, we are not being asked to include toll or vertical services costs within the price of the loop, which in any event, would violate the FCC's rules for pricing UNEs. The Commission has already spoken on that issue, and we will not revisit the issue in this proceeding. However, this case is different because we are dealing with setting a rate for a new UNE—the HFPL—which was created from an existing UNE --the loop-- which includes both high and low frequencies. Parties do not dispute that the loop is a shared physical resource. In other words, we have voice and data service that utilize different portions of the loop, and we need to allocate costs between them

The FCC recognized the need to make some sort of allocation in its Line Sharing Order:

> We note that the TELRIC methodology that the Commission adopted in the *Local Competition First Report*

[31] D.94-09-065, D.96-10-066, and D.96-08-021.

> *and Order* does not directly address this issue. More specifically, the Commission in that order noted that the TELRIC methodology was designed to price 'discrete network elements or facilities,' rather than services. In the case of line sharing, however, the facility in question is, by definition, also used for two incumbent LEC services (local exchange service and interstate access service). We are thus presented with the question of how to establish the forward looking economic cost of unbundled bandwidth on a transmission facility when the full embedded cost of that facility is already being recovered through charges for jurisdictional services. Accordingly, we must extend the TELRIC methodology to this situation and adopt a reasonable method for dividing the shared loop costs.[32]

The FCC clearly points to the need to come up with a reasonable method of allocating the shared loop costs. As we stated in our decision in the Interim Arbitration phase of this proceeding, the FCC acknowledges that the FCC-adopted TELRIC methodology does not directly address the issue of pricing a line-shared loop.[33] In other words, we need to allocate prices to voice service and the HFPL, using our interim adopted $9.93 loop price as the ceiling for the adopted rates, since that amount has been determined to recover all costs—including shared and common costs—associated with the loop. Pacific asks that we allocate 50% of the price of the loop to the HFPL, but we have already rejected Pacific's proposal since Pacific proposes to use that revenue to make up some of its alleged shortfall in revenues from residential basic exchange service, which violates the FCC's rules for the pricing of UNEs. Also, Pacific's proposal

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[32] Line Sharing Order ¶ 138 (footnotes omitted).

[33] D.00-09-074 at 16.

does not divide the shared loop costs between the high and low frequency portions of the loop, as the FCC directs in ¶ 138 above. Instead, it proposes to *add* a price for the HFPL, in addition to the price for the loop as a whole.

TURN proposes an allocation of 25% based on the Shapley Value, based on the theory that four major services utilize the loop: basic exchange service, toll/access, vertical services, and the HFPL. Rhythms criticizes TURN's allocation saying that there are many other services that utilize the loop, including 911, 800 and 976 services, directory assistance and operator services. While Rhythms is correct that other services utilize the loop, we find that TURN has identified the four major users of the loop, and indeed 800 service is a subset of toll service. Therefore, we will adopt TURN's proposal that 25% of total loop costs be allocated to the HFPL. This allocation yields a rate of $2.48 for Pacific.

In its Reply Comments, Pacific asserts that the DD correctly held that the loop is a shared facility, the cost of which should be divided among those services using the loop. However, Pacific disputes the DD's conclusion that there are four major services that utilize the loop, rather than two.[34] Pacific argues that it is not appropriate to apportion the shared cost of the loop across four main types of services when not all customers use all four types of service. Verizon asserts that the result of a Shapley allocation is an "arbitrary pro rata share" of costs (Verizon at 6). TURN responds to theses charges stating that it is indisputable that voice services use the loop and that the Shapley Value approach identifies groups of services that make market and regulatory sense. The result of applying the Shapley Value is to make the users of the shared

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[34] Reply Comments of Pacific Bell Telephone Company on Draft Decision, June 14, 2002, at 21-22.

facility better off than if they were not sharing. TURN describes the shared cost problem as "thorny" but reiterates that the Commission must set a price for the HFPL UNE. According to TURN, the DD adopts the Shapley Values economic tool to develop the monthly price because it provides the Commission with an unbiased, impartial, straightforward analytical means of addressing the problem of how to determine a just and reasonable monthly recurring price for the HFPL UNE.

We concur with TURN's reasoning. The allocation using the Shapley Value is not "arbitrary" as Verizon suggests. It is based on analysis of the major uses of the loop, and therefore provides us with a way to allocate costs between the HFPL and other uses of the loop. Again we reiterate that this is a policy determination since, as the FCC acknowledges, we cannot use standard TELRIC methodology to price the HFPL.

Pacific and Verizon assert that the DD overturns D.96-08-021 without factual or evidentiary support. According to Pacific neither TURN nor any other party has presented any testimony in this proceeding supporting the position that the Commission erred in its prior determination that it is improper to allocate loop costs to "toll and other services that use the loop." TURN responds saying that the plain language of the Pub. Util. Code § 1708 gives the Commission ample authority to adopt the conclusions set forth in the DD. The Commission has the authority to alter a prior precedent if warranted by the record in the case. Indeed, the cases relied on by Pacific, Verizon and the Joint CLECs were themselves a change of prior precedent. TURN points out that prior to D.94-09-065 the Commission had determined that loop costs were shared costs, caused by all of the services that use the loop, and rejected the argument that loop costs are a direct cost of local service as "nonsensical." (D.84-06-113 at 455.) In D.94-09-065, the Commission changed its mind.

TURN and ORA conclude that they do not believe that the Commission would be altering precedent if it adopts the DD, but they point out that the Commission has the authority to do so, based on consideration of the facts before it. TURN and ORA assert that this is particularly important given the provision of advanced services. Indeed, it is speculated that the HFPL will carry the vast majority of voice and data service in the not too distant future. The Commission needs, and has, the authority to reach decisions that reflect changed circumstances. We concur with TURN/ORA's argument. We have the authority under Pub. Util. Code § 1708 to change a prior Commission order, once parties are given notice and an opportunity to be heard. The telecommunications sector has changed since the passage of the Telecommunications Act in 1996, and we must be able to set policies that reflect those changes.

We need to set up a process to address future changes in circumstances so that minor changes do not have to be brought back to the Commission for review. At any time that the Commission's adopted loop rate for an ILEC changes, the rate for the HFPL will also recalculated, based on 25% of that adopted loop price. Telecommunications technology is changing at a rapid pace, and we want to take into account the fact that another major revenue stream could be developed that uses the loop. This new future service could cause us to change our policy of allocating 25% of the loop price to the HFPL. Any party to this proceeding may file a motion in this docket to open the proceeding to re-examine the allocation issue as a result of changes in technology. Such motion should include specific information on new and significant uses of the local loop that warrant changing the allocation factor.

Verizon presents a special challenge, since the Commission has not yet adopted a loop price for Verizon. Both ORA and Verizon propose continuation of the current $3.00 rate, although for different reasons. Verizon made that proposal as an interim rate, which would be adjusted in the final costing phase of this proceeding. However, as we stated above, this **is** the proceeding to set a final permanent rate for the HFPL for both Pacific and Verizon, and we do not intend to revisit this issue in the costing phase.

Since we currently have no adopted loop rate for Verizon, and we have rejected use of rates obtained from using the FCC's HCPM, we cannot at this time employ the Shapley Value to determine an appropriate HFPL rate for Verizon. However, once we adopt a UNE loop rate for Verizon, the rate for the HFPL portion will be set at 25% of that adopted loop rate. In the interim, we will continue the $3.00 HFPL rate adopted in the Interim Line Sharing phase of this proceeding.

Rhythms raises the issue of geographic deaveraging of loop prices. We recently adopted interim geographically deaveraged loop rates for Pacific in D.02-05-042. Since the HFPL rate we have adopted is set as a percentage of the adopted loop costs, that rate would vary by geographic zone. The HFPL rate shall be set at 25% of the adopted loop rate for each geographic zone. Once we adopt geographically deaveraged loop rates for Verizon, the HFPL prices in each zone will also be set using the 25% allocation we have adopted here.

6. Having a Positive Monthly Recurring Rate for the HFPL Results in Over-Recovery of Loop Costs

6.1 Parties' Positions

6.1.1 TURN's Position

TURN contends that the Commission must adopt appropriate measures to prevent double recovery. According to TURN, Pacific and Verizon already have an opportunity to recover their full costs through regulated rates and charges. In a letter to the FCC, Verizon's predecessor GTE stated, "[s]ince

ADSL employs the existing loop for new applications, the costs of the loop are already recovered through existing rates." (Rhythms, Murray, Direct Testimony at 15.) Pacific made a similar statement to the CPUC in support of its ADSL filing. The introduction of a new charge for the HFPL allows Pacific and Verizon to collect another charge for the use of the loop, thereby providing them with double recovery.[35]

Arguments by Pacific and Verizon that they are not collecting all of their loop costs should be rejected. These companies themselves argued to the FCC that 100% of their loop costs are recovered through existing services and charges.

TURN suggests that while the most straightforward manner to correct the over-recovery of loop costs would be to reduce basic rates by the amount of HFPL recovery, that may not be the best solution. Since HFPL is a new product it would require frequent adjustments to basic rates. TURN states that a reasonable option is to refund the HFPL income to ratepayers by an offset to the universal service fund, specifically the California High Cost Fund-B (CHCF-B). This will assure that Pacific and Verizon do not reap a windfall profit from sales of HFPL, and ensure that ratepayers as a group are reimbursed for overpayment of loop costs.

TURN rebuts Rhythms' argument that refunding the HFPL income via the universal service fund would amount to using HFPL money to support universal service, thereby creating another subsidy. Rhythms apparently misunderstands TURN's and ORA's proposal. Under their proposals, HFPL

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[35] TURN indicates that the use of the term "double" recovery is not intended to quantify the recovery as two times costs, but rather refers to the recovery of loop costs in two places, resulting in overrecovery. We concur with this definition.

revenues are put into the high cost fund and a like amount of money is not collected from ratepayers. There is no increase in the high cost fund, nor does it represent a new subsidy. The CHCF-B is kept at the same level and is simply used as a convenient mechanism to reduce ratepayers' rates.

6.1.2 ORA's Position

According to ORA, under the current regulatory structure, Pacific and Verizon already recover the full cost of their loops. Thus, a monthly recurring charge for the use of the HFPL will result in additional revenues for them. If Pacific and Verizon were allowed to keep these revenues without any offsets, there would be a windfall profit from sales of the HFPL UNE. In order to prevent the over-recovery of loop costs, Pacific and Verizon should be required to refund the revenues derived from the sale of the HFPL to ratepayers by an offset to their draws from the CHCF-B. Specifically, these new revenues should be offset dollar-for-dollar against Pacific's and Verizon's external subsidy draws.

6.1.3 Rhythms' Position

Rhythms concurs with TURN and ORA's assertion that since the ILECs already fully recover their loop costs, a monthly recurring charge for use of the HFPL would result in new revenues for them that amount to double recovery.

6.1.4 Pacific's Position

According to Pacific, Pacific does not receive a "windfall" from a positive price for access to the HFPL because that argument relies on the premise that Pacific fully recovers the costs of the loop from basic service revenues. Pacific asserts that its basic exchange service, including the local loop, is priced well below cost. As described by Pacific's witness Scholl, the sum of Pacific's 1FR [residential flat-rated service] revenues, the associated End User Common

Line (EUCL) revenues and the CHCF-B revenues equal less than the cost of providing the local loop. Pricing the shared loop at $5.85 does not comprise a “windfall”, but instead merely helps to make up this shortfall. After all, as Scholl states, any CLEC can purchase an unbundled loop for the purpose of providing DSL service and can then provide an end-user with both basic and DSL service over that loop. If there was such a windfall as TURN’s witness Murray describes, there would be a stampede of others seeking to provide that combination themselves. The fact that such stampede has not occurred clearly refutes her claim.

Pacific rebuts Rhythms claims that “the Commission has already created an explicit universal service funding mechanism that is designed to deliver all of the subsidy that the Commission deems necessary to support residential basic exchange service.” (Rhythms Opening Brief at 21.) According to Pacific, Rhythms is wrong. The Universal Service proceeding provided subsidies to high cost areas—areas in which lines cost more than a Commission-determined average—not to all residential 1FR lines. The Universal Service decision did not foreclose the Commission from following NRF and allowing new products to contribute to loop costs.

Second, under NRF principles, a positive price for access to the HFPL is not a windfall but instead an appropriate incentive for an ILEC to develop innovative products and services. As Pacific’s witness Jacobsen described in his testimony, an important principle of NRF is that reward should follow risk. Clearly, Pacific’s shareholders bear the risk of the investment Pacific has made to develop widespread DSL availability. Under NRF, shareholders should now be compensated for this risk. Pacific states that the price of $5.85 is far from a windfall, but instead merely some compensation for shareholders in exchange for the risks they have borne.

Pacific asserts that a $5.85 price is consistent with the Commission's holdings in its NRF proceeding. Two of the goals of NRF are the encouragement of technological advancement and full utilization of the network through retaining and expanding the customer base for existing services and adding new services. HFPL is a prime example of a new service that has been developed through technological advancement. In order to ensure that NRF's goals are met, Pacific must be allowed to charge reasonable prices for new products that are developed through these technological advancements. Consequently, a $5.85 price for access to the HFPL is consistent with NRF.

Pacific states that although the evidence indicates that no offset is appropriate, it is also clear that the CHCF funding mechanism should not be modified in this proceeding. The funding mechanism and purpose was defined in D.96-10-066. Parties who recommend that the Commission now divert HFPL revenue into that fund are essentially asking the Commission to modify that Decision. This is not the proceeding in which to modify D.96-10-066. This proceeding has involved only a select few active parties. Other interested parties should be entitled to appear and comment on changes to the CHCF-B.

6.1.5 Verizon's Position

Verizon asserts that it is not appropriate to offset any portion of a positive price for the HFPL. First, revenue derived from the HFPL element should not be considered a windfall profit requiring any sort of offset. Under Verizon's proposed methodology, a non-zero price would be equal to the direct additional cost associated with the HFPL, plus a reasonable allocation to common costs. According to Verizon, this is no different from any other UNE price established by the Commission.

Second, Verizon states that even if the Commission determines that a non-zero price for the HFPL represents an allocation of loop costs or a reasonable contribution for common cost recovery, the revenues derived in this manner would not constitute a windfall profit requiring a rate adjustment or offset. Verizon operates under the Commission's NRF, and is regulated on an incentive basis. As such, Verizon's shareholders are at risk for their management's ability to generate greater efficiencies, cost savings, and revenue sources to offset the effects of inflation and losses of revenue to other carriers in the competitive marketplace. On the other hand, Verizon's ratepayers are insulated from negative impacts due to inflation or competitive losses. In this context, the HFPL is nothing more than a new revenue source. According to Verizon, there is absolutely nothing unique or special about the HFPL revenues.

Verizon asserts that its draw from the CHCF-B should not be either reduced or offset if there is a positive price for the HFPL. Verizon is already fully offsetting its draw from this fund via compensating surcredits. Given that, any additional rate reductions or offsets would be inappropriate.

6.1.6 Discussion

Both Pacific and Verizon asserted in their filings at the FCC when they filed for authority to offer ADSL service that they were recovering the full cost of the loop from existing services. In its June 26, 1998 reply filing at the FCC, Pacific asserts as follows:

> Several petitioners contend that Pacific must assign outside plant (local loop) costs to its ADSL service. But Commission rules impose no such requirement. FCC Rule 61.38 requires LECs to identify the direct cost to provide the proposed new service. Pacific proposes to transmit ADSL over loops already in service. Pacific already recovers the costs of those local loops under tariffs already approved by the Commission and state

> regulators. Loop costs therefore contribute nothing to the direct cost of ADSL service.[36]

Pacific made a similar statement in responding to protests to its filing at this Commission of an intrastate ADSL tariff:

> Protestants fail to come to grips with the fact that Pacific Bell's retail end users already pay the Commission-approved and FCC approved prices that recover the cost of the copper loop over which the ADSL service is placed.[37]

Verizon has made similar attestations. Verizon's predecessor GTE has stated:

> [s]ince ADSL employs the existing loop for new applications, the costs of the loop are already recovered through existing rates.... [38]

The ILECs have stated to both this Commission and the FCC that they recover the cost of the loop through tariffed services. They made that statement at a time when it was to their benefit <u>not</u> to allocate any costs to the high frequency portion of the loop, and there were no competitors using those line-shared loops. We do not find convincing their more recent assertions that they do not recover the costs of the loop from their tariffed services. Their

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[36] Reply of Pacific Bell, In the Matter of Pacific Bell, Pacific Tariff FCC No. 128, Transmittal No. 1986, Pacific's ADSL Service, (June 26, 1998) at 15 (footnotes omitted

[37] Letter from Isabelle M. Salgado, Senior Counsel, Pacific Telesis Legal Group, Re: Response to Protests Regarding Pacific Bell's Advice Letter 19543 (August 4, 1998).

[38] GTE's Reply, In the Matter of GTE Telephone Operating Companies Tariff FCC No. 1, Transmittal No. 1148, May 28, 1998, at 18 (footnote omitted).

arguments are self-serving attempts to retain the revenues they obtain from leasing the HFPL to other carriers.

We agree with TURN's conclusion that the introduction of a charge for the HFPL allows Pacific and Verizon to collect another charge for the use of the loop, thereby providing them with "double recovery." In other words, if Pacific and Verizon were to assess a charge for the data portion of the loop, they would recover more than the full cost of the loop. We have already rejected Pacific's allegation that it should keep the HFPL revenues to make up for the shortfall in residential basic exchange service and found that it violated the FCC's rules for pricing of UNEs. We also rejected Verizon's "embedded constraint" theory, which would have allowed the company to recover costs associated with plant in its copper network as being inconsistent with the FCC's rules for pricing of UNEs.

Pacific and Verizon muddy the waters with their allegations that NRF principles mandate that shareholders who bear the risk of investment in DSL technology should be compensated for this risk. Verizon sees DSL service as nothing more than a new revenue source, with nothing special about HFPL revenues. We disagree. We stand by the principles we adopted over a decade ago when we implemented incentive regulation for our two largest ILECs. However, while our NRF framework is still in place, the world of telecommunications changed dramatically with passage of TA96. The FCC has enacted rules to deal with the new regulatory environment, and included in those rules are rules for the pricing of UNEs. We are obliged to follow the FCC's rules in the pricing of UNEs.

We find that Pacific and Verizon should not be allowed to retain the HFPL revenues since it would result in their over-recovery of loop costs. In addition, it eliminates any possibility of cross-subsidization, since all CLECs—

including ASI and VADI—would pay the same rate and those revenues would not be retained by the ILECs.

Parties propose that the HFPL revenues should be returned to ratepayers, and we concur with that suggestion. However, we need to examine the best way to return the revenues to ratepayers and determine which ratepayers should receive the benefit.

TURN suggests that the most straightforward manner to correct the over-recovery of loop costs would be to reduce basic rates by the amount of HFPL recovery, but then rejects that option because it could result in frequent adjustments to basic rates.

ORA and TURN both present slightly different options for returning HFPL revenues to ratepayers. Both options involve use of the CHCF-B. ORA proposes to require the ILECs to refund the revenues from the sale of the HFPL by an offset to their draws from the CHCF-B, while TURN proposes that the revenues from HFPL be transmitted to the CHCF-B and used to offset the amount of surcharge collected from ratepayers. We agree with Pacific's statement that this proceeding is not the appropriate place to modify our universal service funding mechanism, as adopted in D.96-10-066.

In their comments on the DD, Pacific, Verizon and the Joint CLECs[39] assert that the proposal to refund the HFPL revenues to all basic exchange ratepayers would constitute an illegal subsidy for voice services. The Joint CLECs assert that by diverting the refund away from the actual customers who pay the HFPL charge, the DD's refund mechanism would cause DSL customers to pay more for the local loop than voice-only customers. Thus, the DD's

[39] WorldCom, AT&T, Sprint, and Covad.

proposal sets up an improper cross subsidy—taking revenues from DSL customers and giving those revenues to the majority of local exchange customers.

TURN and ORA defend the DD's surcredit method, stating that the surcredit mechanism is designed to ensure the ILECs do not over-recover the costs of the loop. As TURN's witness Roycroft discusses, it is appropriate to credit this money back to all local exchange customers, as opposed to just DSL customers, because all users of the loop benefit from the increased economies of scope brought on by line sharing. These increased economies of scope result in lower costs for all services using the loop. While in a competitive market this decrease in costs would be reflected in lower prices, because this is not a truly competitive market regulators must supervise the allocation of these savings. A surcredit, while not as direct as a decrease in local exchange rates, is an appropriate method of allocation. (Roycroft for TURN, Reply Testimony at 10-11, 13.)

We concur with TURN/ORA's conclusion that all customers benefit from the economies of scope brought on by line sharing. Since it is appropriate that all customers share in surcredit, we will order each ILEC to return those revenues to ratepayers using their A-38 (Verizon) and Rule 33 (Pacific) surcharge/surcredit mechanisms.

While parties proposed returning the revenues to DSL customers, in reviewing comments on the RDD, it became clear that this is not a viable option. We proposed to have the ILECs return the revenues to CLECs, who would be required to return the revenues to their DSL customers. However, as various parties pointed out, Internet Service Providers (ISPs) make up a significant proportion of a CLEC's customers, and we do not have the regulatory authority over ISPs to require them to return revenues to their end-user customers. It is not our intention to have the refund go to ISPs, so we have abandoned that proposal. Also, it is clear from their comments on the RDD, that it would be costly and cumbersome for Pacific and Verizon to reimburse their voice customers who purchase DSL from a CLEC.

Parties raised an additional concern with the DD's refund mechanism. The Joint CLECs assert that once Pacific and Verizon reintegrate their data affiliates, the ILEC may not incur a positive monthly charge for the HFPL, which would result in a price squeeze. TURN responds that the problem can be easily remedied by requiring an ILEC to impute the monthly recurring charge to its DSL service. According to TURN, this would eliminate the price squeeze problem and ensure non-discriminatory pricing treatment of DSL providers. Verizon argues that the Joint CLECs' analysis is incorrect. CLECs have the option of leasing the entire UNE loop to provide both voice and data services, thereby avoiding the HFPL rate entirely. According to Verizon, even if a CLEC does not provide voice services, it can jointly market an integrated package with another CLEC that would use the low frequency portion of the loop. According to Verizon, CLECs have options available to prevent any price squeeze.

We are concerned with the potential of discriminatory treatment if/when the ILECs reintegrate their data affiliates. Verizon has already filed to reintegrate VADI in A.01-11-014, and that issue will shortly be pending before the Commission. We do not have the record in this proceeding to address this potential problem, but we will require the assigned ALJ to open the record to collect additional comments on the potential of a price squeeze if an ILEC reintegrates its data affiliate.

7. True-up and Treatment of Balances in Memoranda Accounts

The FAR adopted in the ILS Interim Opinion ordered Pacific and GTE (now Verizon) each to maintain a memorandum account to record revenues from the monthly recurring charge for access to the HFPL. The FAR also held that the memorandum account would be subject to interest, either by the application of interest on the balance, or the application of interest on any amounts later subject to true-up adjustments. (FAR at OP 8.)

In the FAR in our interim line sharing phase, we indicated that the amounts in the memoranda accounts would be subject to true-up. The purpose of a true-up is to reimburse carriers for overcharges or undercharges in the amount charged for the HFPL between the time the interim rates went into effect, and the implementation of permanent rates adopted in this decision. In this decision, we adopt an HFPL rate of $2.48 for Pacific, while the interim rate was $5.85, for a difference of $3.37. Pacific shall reimburse carriers (including its affiliate ASI) which purchased the HFPL over the past several months since the interim rates went into effect with $3.37 per month / per line. Since we adopted the same rate for Verizon as was adopted in the interim phase, Verizon is not subject to the true-up provisions.

Parties were put on notice in the ILS phase of the possibility of a true-up,[40] and in its Line Sharing Order, the FCC acknowledged that states might need to issue interim arbitration awards, subject to a true-up:

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[40] Final Arbitrator's Report, Ordering Paragraph 8 states: "The memorandum account shall be subject to interest, either by the application of interest on balance, or the application of interest on any amounts later subject to true-up adjustment."

> In addition, as explained in more detail below, we strongly encourage the states of issue interim arbitration awards setting out the necessary rates, terms, and conditions for access to this unbundled network element, with any unresolved issues subject to a true-up when the state commission completes its arbitration.[41]

ORA asserts that the balance in the memorandum accounts should be used to reduce Pacific and Verizon's voice customers' rates such that the reduction in revenues from voice customers matches the increase in revenues from line sharing service. It is only equitable that voice customers should realize reduced rates as a result of increased revenues from line sharing if those revenues are greater than the ILEC costs associated with use of the HFPL. ORA proposes that the money in the memorandum accounts be returned to ratepayers through the CHCF-B.

With the exception of those Pacific revenues which are subject to the true-up described above, we will treat the revenues in each ILEC's memorandum account in much the same way that we have treated HFPL revenues on a going-forward basis, as described in the proceeding section. Each ILEC shall return those amounts in the memo accounts, with interest, to Ratepayers using their A-38 (Verizon) and Rule 33 (Pacific) surcharge/surcredit mechanisms. The revenues shall be returned to ratepayers over a six-month period. This surcredit will be calculated separately from that described above for use on a going-forward basis. Within 60 days of the effective date of this order, the ILECs shall file advice letters that reflect the change in the A-38 and Rule 33 surcharge/surcredit amounts. TD shall be responsible for reviewing the advice lettes to ensure compliance with this order.

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[41] <u>Line Sharing Order</u> ¶ 160.

8. Limited Exogenous (LE) Factor Treatment

In their comments on the DD, Pacific and Verizon both assert that the administrative costs associated with any HFPL refund meet the criteria for LE Factor recovery under our NRF framework. Pacific states that in D.98-10-026, the Commission established rules for carriers seeking recovery of costs incurred as a result of Commission mandates. Pursuant to that decision, those costs would be recovered through an LE factor mechanism, under which carriers must demonstrate that the requested costs meet certain specified criteria. As a prerequisite to seeking LE factor treatment, a carrier must show that an LE factor adjustment is authorized in the underlying Commission decision.

Pacific indicates that if the Commission orders it to implement the HFPL surcredit described in the DD, it will incur significant administrative costs. Pacific requests that the DD be modified to include language authorizing Pacific to seek LE factor recovery for costs incurred in implementing the processes ordered in the Commission's final HFPL decision.

In its Opening Brief, Verizon makes the comment that the arbitrator in the interim phase incorrectly ruled that the revenues associated with access to the HFPL should be subject to LE factor treatment under NRF. Verizon points out that the LE factor was intended to address *cost* changes, not *revenues*, and in any event, this event would not satisfy the nine criteria for LE factor treatment established by the Commission. The Final Arbitrator's Report in the Interim Line Sharing proceeding indicates that the balance in the memorandum account shall be subject to limited exogenous factor treatment under the CPUC's NRF framework. (FAR at 124.)

We grant Pacific and Verizon the authority to request LE factor treatment, since they were given the expectation in the Interim Phase that they would be authorized to seek LE factor recovery. However, we clarify here that LE factor treatment is for the administrative costs associated with returning HFPL revenues to ratepayers, and we caution the ILECs that we expect those administrative costs to be minimal, since we are using existing surcharge/surcredit mechanisms.

9. Comments on Draft Decision

The draft decision of ALJ Jones in this matter was mailed to the parties in accordance with Pub. Util. Code Section 311(g)(1) and Rule 77.7 of the Commission's Rules of Practice and Procedure. Comments were filed on June 7, 2002 and reply comments, on June 14, 2002. The revised DD was mailed to the service list for the proceeding and to all certificated CLECs on November 1, 2002. Comments were filed on November 21, 2002 and reply comments were filed on November 26, 2002. We have reviewed the comments and taken them into account, as appropriate, in finalizing this order.

10. Assignment of Proceeding

Carl Wood is the Assigned Commissioner and Karen Jones is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. State Commissions have the authority to establish additional UNEs pursuant to § 51.317.

2. Line sharing is the only viable option for a CLEC who seeks to compete with the incumbent LEC in providing DSL service at retail.

3. Under current FCC regulations, a CLEC has no right of access to the high-speed transmission component of cable modem service, which is the functional equivalent of DSL service.

4. The FCC's language in the Line Sharing Order is permissive when it says that states "may" require the ILECs to charge no more than the amount of loop

costs allocated to ADSL services in their Federal filings to establish their interstate retail rates for the service.

5. The FCC is silent on the rules to follow in setting of permanent HFPL prices.

6. The HFPL does not fall within the definition of universal service.

7. It is an economically correct outcome to have a positive price for access to the HFPL.

8. An ILEC should not have to subsidize a competitor's operation by providing a valuable asset at no charge.

9. The proper charge for the HFPL is a policy issue and is not based on a TELRIC cost study for the HFPL.

10. In D.99-11-050 the Commission adopted a loop rate of $11.70 for Pacific.

11. The record of this proceeding does not allow validation of TURN's HCPM calculations or Verizon's ICM model.

12. 47 C.F.R. § 51.505(d) lists the factors that may not be considered in calculation of the forward-looking economic cost of a network element.

13. It is not economically feasible for a competitor to pay $11.70 for a loop, and then attempt to compete against the ILEC, or its affiliate's DSL service provided over less expensive line-shared loops.

14. This phase of the PLS proceeding is scheduled to set a permanent price for the HFPL to replace the interim rates adopted in the interim arbitration phase in D.00-09-074.

15. In D.02-05-042 the Commission adopted an interim loop rate of $9.93 for Pacific.

16. This decision adopts a process to automatically change the rate for the HFPL, if the rate for the unbundled loop changes.

17. This proceeding does not deal with the issue of whether to treat basic service, or the UNE loop, as a shared cost, as was the case in D.94-09-065, D.96-08-021, and D.96-10-066.

18. The Commission is not being asked in this proceeding to include some of the costs of toll or vertical services within the price of the loop.

19. The loop is a shared physical resource.

20. Two UNEs utilize the loop, and costs need to be allocated between them.

21. The FCC acknowledges that the FCC-adopted TELRIC methodology does not directly address the issue of pricing a line-shared loop.

22. The four major users of the loop are: basic exchange service, toll/access, vertical services, and the HFPL.

23. Under the Shapley Value, Pacific's rate for the HFPL, given its current interim loop rate, is $2.48.

24. The Commission has not yet adopted a loop price for Verizon.

25. Since there is no adopted loop rate for Verizon, the Shapley Value cannot be used to determine an appropriate HFPL rate for Verizon.

26. Pacific and Verizon asserted in their filings at the FCC that they were recovering the full cost of the loop through existing services.

27. Introduction of a charge for the HFPL allows Pacific and Verizon to recover more than the full cost of the loop.

28. This proceeding is not the appropriate place to modify our universal service funding mechanism, as adopted in D.96-10-066.

29. The purpose of a true-up is to reimburse carriers for overcharges or undercharges in the amount charged for the HFPL between the time the interim rates went into effect, and the effective date of the permanent rates adopted in this decision.

30. A true-up is warranted for Pacific because the rate adopted for Pacific in the interim phase was $5.85, while a permanent rate of $2.48 is being adopted in this decision.

31. No true-up is warranted for Verizon because the rate adopted for Verizon in the interim phase--$3.00--was identical to the rate adopted in the permanent phase.

32. It is appropriate to return HFPL revenues to all ratepayers, as opposed to just DSL customers, because all users of the loop benefit from the increased economies of scope brought about by line sharing.

Conclusions of Law

1. The FCC's line sharing order is not vacated, and continues to apply as a matter of law until January 2, 2003.

2. The Commission has independent authority pursuant to Pub. Util. Code § 709.7 to require line sharing and to set permanent rates for the line-sharing UNE.

3. The FCC's Line Sharing Order does not require the states, in setting permanent HFPL rates, to rely on the loop costs allocated to ADSL services in ILECs' interstate filings with the FCC.

4. This Commission has the authority, under the FCC's rules, to set HFPL rates at either a zero-rate or at a rate other than zero.

5. The Commission may decide to endorse all or some of the rulings in D.00-09-074, but is not required to do so, since it has developed a separate record in this proceeding.

6. The Commission should not rely on either the HCPM or Verizon's ICM in making a determination of the proper price for the HFPL.

7. The HFPL is being priced as a UNE, and the Commission must follow the FCC's rules for pricing UNEs.

8. Pacific's proposal to collect $5.85, or 50% of the adopted loop rate, to make up for the shortfall in residential basic exchange revenues, violates 47 C.F.R. § 51.505(d)(4).

9. Verizon's "embedded constraint" theory violates 47 C.F.R. § 51.505(d)(1).

10. The $9.93 interim loop price adopted by the Commission for Pacific has been determined to recover all costs—including shared and common costs—associated with the loop.

11. Twenty-five percent of total loop costs should be allocated to the HFPL.

12. If an ILEC's adopted loop rate changes, the rate for the HFPL will also be recalculated based on 25% of the adopted loop price.

13. If the Commission has adopted geographically deaveraged loop rates for a particular ILEC, the HFPL rate should be set at 25% of the adopted loop rate for each geographic zone.

14. The Commission is obligated to follow the FCC's rules in pricing UNEs.

15. Pacific and Verizon should not be allowed to retain the HFPL revenues since it would result in over-recovery of loop costs.

16. Pacific should reimburse carriers (including its affiliate ASI) which purchased the HFPL over the past several months since the interim rates went into effect with $3.37 per month/per line.

17. The HFPL revenues should be returned to ratepayers as a group.

18. Returning the HFPL revenues to ratepayers does not violate FCC Rule 51.505(d)(4).

19. Pacific and Verizon should aggregate their HFPL revenues in an interest-bearing account for return to ratepayers in the form of a surcredit.

20. Pacific and Verizon are authorized to request Limited Exogenous Factor treatment for the administrative costs associated with returning HFPL revenues to ratepayers.

INTERIM ORDER

IT IS ORDERED that:

1. Pacific Bell Telephone Company (Pacific) and Verizon California Inc. (Verizon) shall continue to offer the High Frequency Portion of the Loop (HFPL) to Competitive Local Exchange Carriers.

2. Pacific and Verizon shall implement the rates for the HFPL adopted herein within 30 days of the effective date of this order.

3. Within 60 days of the effective date of this order, Pacific shall reimburse CLECs (including its affiliate ASI) which purchased the HFPL over the past several months since the interim rates went into effect with $3.37 per month/per line, plus interest.

4. With the exception of the revenues referred to in Ordering Paragraph 3 above, Pacific and Verizon shall return all the revenues, plus interest, in the memoranda accounts established pursuant to D.00-09-074 to ratepayers through their existing A-38 (Verizon) and Rule 33 (Pacific) surcharge/surcredit mechanism. Verizon and Pacific shall file advice letters within 60 days of the effective date of this order to make the appropriate change to their respective A-38 and Rule 33 surcharge/surcredit mechanisms.

5. On a going forward basis, Verizon and Pacific shall file advice letters to change the A-38 and Rule 33 surcredit amounts within 30 days of the close of each six-month period following the effective date of this order. Surcredits to ratepayers shall be on a monthly basis thereafter, following an initial two-month lag time to allow time to calculate the surcredit amounts.

6. The Commission's Telecommunications Division shall review the advice letters to ensure compliance with this order.

7. If the loop rate for an ILEC changes, the rate for the HFPL shall be recalculated, based on 25% of that adopted loop rate.

8. Once the Commission establishes a UNE loop rate for Verizon, the price for the HFPL portion shall be set at 25% of that adopted loop rate.

9. In the interim, the $3.00 HFPL rate adopted in D.00-09-074 shall be maintained for Verizon.

10. With 15 days of the effective date of this order, the Assigned Administrative Law Judge shall issue a ruling to solicit comments on whether Incumbent Local Exchange Carrier (ILEC) reintegration of a data affiliate could result in price squeezes or other anticompetitive behavior on the part of the ILECs.

11. The May 24, 2002 motion of Verizon California Inc. to suspend the comment period of the Draft Decision and not put the Draft Decision on the Commission’s meeting agenda until further notice, is hereby denied.

12. The November 21, 2002 motion of Speakeasy, Inc; Earthlink, Inc; Sonic-Net Inc; InReach Internet LLC; DirecTV Broadband, Inc; and DSLExtreme.com to intervene in this proceeding is hereby denied.

This order is effective today.

Dated ____________________________, at San Francisco, California.

APPENDIX A

LIST OF APPEARANCES

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